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In the Supreme Court of the United States

OCTOBER TERM, 1950

No. 332

CLAWSON & BALS, INC., *Petitioner*

v.

THE UNITED STATES OF AMERICA

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

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BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the Court of Appeals (R. 107-114) is reported at 182 F. 2d 402. The memorandum findings of fact and conclusions of law of the District Court (R. 89-93) are reported at 86 F. Supp. 457.

JURISDICTION

The judgment of the Court of Appeals (R. 114) was entered on May 26, 1950. A petition for rehearing (R. 117-125) was denied on June 29, 1950

(R. 127). The petition for a writ of certiorari was filed on September 22, 1950. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTION PRESENTED

Whether taxpayer was a "manufacturer" of automobile connecting rods within the meaning of Section 3403(c) of the Internal Revenue Code, which imposes an excise tax upon automobile parts "sold by the manufacturer, producer, or importer" thereof.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code:

> SEC. 3403 [As amended by Sec. 544(b), Revenue Act of 1941, c. 412, 55 Stat. 687]. TAX ON AUTOMOBILES, ETC.
>
> There shall be imposed upon the following articles sold by the manufacturer, producer, or importer, a tax equivalent to the following percentages of the price for which so sold:
>
> * * *
>
> (c) Parts or accessories (other than tires and inner tubes and other than radios) for any of the articles enumerated in subsection (a) or (b), 5 per centum. For the purposes of this subsection and subsections (a) and (b), spark plugs, storage batteries, leaf springs, coils, timers, and tire chains, which are suitable for use on or in connection with, or as component

parts of, any of the articles enumerated in subsection (a) or (b), shall be considered parts or accessories for such articles, whether or not primarily adapted for such use. This subsection shall not apply to chassis or bodies for automobile trucks or other automobiles. Under regulations prescribed by the Commissioner, with the approval of the Secretary, the tax under this subsection shall not apply in the case of sales of parts or accessories by the manufacturer, producer, or importer to a manufacturer or producer of any of the articles enumerated in subsection (a) or (b). If any such parts or accessories are resold by such vendee otherwise than on or in connection with, or with the sale of, an article enumerated in subsection (a) or (b) and manufactured or produced by such vendee, then for the purposes of this section the vendee shall be considered the manufacturer or producer of the parts or accessories so resold.

* * *

(26 U. S. C. 1946 ed., Sec. 3403.)

SEC. 3443 [As amended by Sec. 553(d), Revenue Act of 1941, supra]. CREDITS AND REFUNDS.

(a) A credit against tax under this chapter, or a refund, may be allowed or made—

(1) to a manufacturer or producer, in the amount of any tax under this chapter which

has been paid with respect to the sale of any article (other than a tire, inner tube, or automobile radio taxable under section 3404) purchased by him and used by him as material in the manufacture or production of, or as a component part of, an article with respect to which tax under this chapter has been paid, or which has been sold free of tax by virtue of section 3442, relating to tax-free sales.

* * *

(26 U. S. C. 1946 ed., Sec. 3443.)

Treasury Regulations 46, promulgated under the Internal Revenue Code:

SEC. 316.4. *Who is a manufacturer.*—The term "manufacturer" includes a person who produces a taxable article from scrap, salvage, or junk material, as well as from new or raw material, (1) by processing, manipulating, or changing the form of an article, or (2) by combining or assembling two or more articles.

Under certain circumstances, as where a person manufactures or produces a taxable article for a person who furnishes materials and retains title thereto, the person for whom the taxable article is manufactured or produced, and not the person who actually manufactures or produces it, will be considered the manufacturer.

A manufacturer who sells a taxable article in a knockdown condition, but complete as to all component parts, is liable for the tax, and not the person who buys, and assembles a taxable article from, such component parts.

STATEMENT

The taxes here in question were assessed on sales by the taxpayer of rebabbitted or reground connecting rods (R. 4, 6-7). Two methods of rebuilding the used connecting rods, the technical details of which are fully set out in the opinion of the court below (R. 109-111), were used by the taxpayer. Insisting that the work performed on the used connecting rods did not amount to "manufacture" of the rods within the meaning of Section 3403(c) of the Internal Revenue Code (R. 3), taxpayer brought this suit for refund (R. 2-5).

The taxpayer sold the connecting rods processed by it on the basis of an outright price and an exchange price, the exchange price applying where the customer sent in a used rod with his order. The exchange price, added to the value of the outworn rod, determines the cost of the complete and finished rod. Taxpayer returned and paid manufacturer's excise taxes upon all rebabbitted rods it sold, but in computing the tax did not include in the taxable price the amount allowed the customer for used rods. The taxpayer paid no tax whatever upon the connecting rods that were reground.

The Commissioner assessed a deficiency in the amount of $89,315.15, which resulted (1) from including the credit given customers for the used rods as part of the taxable price and (2) from the Commissioner's ruling that the rods that were reground were equally taxable with the rebabbitted rods. The price charged where the customer received back his own rods was, however, held exempt and no deficiency was assessed on this amount (R. 90).

The District Court found *inter alia* that "the used rods received by plaintiff were scrap, *i.e.*, unfit to perform their proper function as connecting rods until re-processed or remade by plaintiff, regardless of whether they were rebabbitted or reground" (R. 93). It concluded that the taxpayer was "a manufacturer of connecting rods and taxable as such" and that the amount of the credit given for the old rods should be considered part of the price (*ibid*). The Court of Appeals affirmed the District Court's judgment in its entirety (R. 114).

ARGUMENT

1. The decision of the court below is in harmony with all the other courts of appeals' decisions involving the same or similar questions. *Clawson & Bals* v. *Harrison,* 108 F. 2d 991 (C. A. 7th), certiorari denied, 309 U. S. 685;[1] *United States* v.

[1] Moreover, the taxpayer may be concluded on the rebabbitting phase by this earlier decision involving the same taxpayer

Armature Exchange, 116 F. 2d 969 (C. A. 9th), certiorari denied, 313 U. S. 573; *United States* v. *J. Leslie Morris Co.,* 124 F. 2d 371 (C. A. 9th); *United States* v. *Moroloy Bearing Service,* 124 F. 2d 373 (C. A. 9th); *United States* v. *Armature Rewinding Co.,* 124 F. 2d 589 (C. A. 8th); *Monteith Bros. Co.* v. *United States,* 142 F. 2d 139 (C. A. 7th).[2]

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for the taxable years, 1932-1935. *Commissioner* v. *Sunnen,* 333 U. S. 591. The facts are the historical, static ones required for the operation of collateral estoppel. See Scott, *Collateral Estoppel by Judgment,* 56 Harv. L. Rev. 1 (1942). The taxpayer's plant superintendent testified (R. 45-48) that there had been no substantial change in the rebabbitting process since the beginning. And as further pointed out by the Court of Appeals (R. 111):

> We find no substantial reason for distinguishing between plaintiff's processes of reconditioning by rebabbitting and by regrinding. In rebabbitting, shims and babbitt and, in some instances a nut or bolt, were added or replaced. In the regrinding process, shims were added; and a brass bushing and, in some instances, a nut or bolt were replaced.

In addition, it should be emphasized that the Court of Appeals (R. 111-112) considered that the rods reconditioned in the earlier years were approximately the same as those which the taxpayer utilized in the years in question.

[2] Three Canadian courts (construing like provisions of the Canadian Revenue Act of 1927) have also held in accordance with the decision below. *Biltrite Tire Co.* v. *The King,* 1937 Canada Law Rep. 364 (Sup. Ct. Canada); *The King* v. *Biltrite Tire Co.,* 1937 Canada Law Rep. 1 (Exchequer Ct. Canada); *The King* v. *Boultbee Ltd.* (1938), Dominion Law Rep. 664.

These decisions have received explicit Congressional approval.[3] In 1941, an attempt to amend the statute here in question was considered by the Senate Committee on Finance. In its report, the Committee stated (S. Rep. No. 673, Part 1, 77th Cong., 1st Sess., p. 48 (1941-2 Cum. Bull. 466, 503)):

> It was urged that this section be amended to specify that repaired, reconditioned, and rebuilt automobile parts and accessories are not subject to the "parts and accessories" tax. Your committee examined the problem very carefully. Repaired and reconditioned parts are not now subject to tax. There are several decisions of the United States circuit courts of appeals holding rebuilt parts and accessories to be subject to the manufacturers' tax. Rebuilt parts compete with new parts, and it appears appropriate that they should be subject to the same tax. Accordingly, no change has been made.

---

[3] Treasury Regulations 46, Section 316.4, *supra*, provide that the term "manufacturer" includes a person who from scrap, salvage or junk material produces a taxable article by processing or changing the form of the article or by combining or assembling two or more articles. Attention is directed to the fact that this provision has appeared in the Treasury Regulations since 1920, during which time the taxing statute has been reenacted several times without material change. Under the established rule, Congress must be taken to have approved the administrative construction and thereby to have given it the force of law. *Helvering* v. *Reynolds Co.*, 306 U. S. 110; *United States* v. *Armature Exchange, supra.*

Other unsuccessful attempts were made in 1942 (House Hearings before the Committee on Ways and Means on Revenue Revision of 1942, 77th Cong., 2d Sess., Vol. 2, pp. 1907-1921; Senate Hearings before the Committee on Finance on H. R. 7378, 77th Cong., 2d Sess., Vol. 1, pp. 1143-1152), 1947 (House Hearings before the Committee on Ways and Means on Revenue Revisions, 1947-1948, 80th Cong., 1st Sess., Part I, pp. 539-547, 657-681) and in 1950 (House Hearings before the Committee on Ways and Means on Revenue Revisions of 1950, 81st Cong., 2d Sess., Vol. I, pp. 1602-1604) by representatives of the automotive replacement parts and rebuilding industry to obtain an amendment to the section to exclude such parts from tax. Hence, the taxpayer seeks here to have the courts do what Congress has consistently refused to do.

In the light of what has already been said, the taxpayer's reliance on judicial and other definitions of the term "manufacture" (Pet. 8-12) is misplaced. For whatever the term may connote in other contexts and under other statutes, its meaning for the purposes of this statute is well settled.

2. The taxpayer further asserts (Pet. 12) that the conclusion of the courts below that a tax is due not only upon the cash received but also upon the value of the materials tendered in exchange, is contrary to Section 3443(a)(1) of the Internal Revenue Code, *supra*, pp. 3-4. But that section in terms provides for a credit only where tax has already been paid on the sale to a manufacturer who, in

turn, uses the article in the manufacture of another article on the sale of which a tax is imposed. Here, of course, there was no tax on the transfer to taxpayer of the scrap rods which it then rebuilt.

3. The taxpayer is incorrect in asserting that this case now presents an important question. In the earlier *Clawson & Bals* case it was admitted (Brief in Opposition, pp. 5-6, No. 786, October Term, 1939), that the question was one of importance since the Treasury needed adequate guideposts in its administration of the taxing statute. Certiorari was nevertheless denied (*Clawson & Bals* v. *Harrison,* 108 F. 2d 991, certiorari denied, 309 U. S. 685), and since that time authoritative guides have been set up by the Courts of Appeals and Congress has both explicitly and implicitly ratified these interpretations. See *supra,* pp. 8-9, and note 3.

Moreover, the contention that this decision will subject repairmen to this tax is unfounded. The District Court found (R. 90) that, where the taxpayer's customer received back from the taxpayer his own rods, the transaction was exempt and no tax was assessed upon the amount charged by the taxpayer for thus rebuilding the customer's rods. The Treasury, in its interpretation of the taxing statute, and the judicial decisions have always expressly distinguished between repairmen and manufacturers. S. T. 582, XI-2 Cum. Bull. 472 (1932); S. T. 896, 1940-1 Cum. Bull. 252; S. T. 927, 1942-2 Cum. Bull. 225; S. T. 932, 1945 Cum. Bull. 431.

And the taxpayer's contention that it simply repaired "used, but not worn-out, connecting rods" (Pet. 7, 8), is in the face of the District Court's finding (R. 93) concurred in by the Court of Appeals (R. 112) that the used rods were "scrap." See *United States* v. *O'Donnell,* 303 U. S. 501, 508.

CONCLUSION

The decision of the court below is not in conflict with any other decision, and it is a correct interpretation of the taxing statute. It is, therefore, respectfully submitted that the petition for a writ of certiorari should be denied.

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OCTOBER, 1950.

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CHARLES ELMORE CROPLEY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1950.

No. 332

CLAWSON & BALS, INC.,
Petitioner,

vs.

THE UNITED STATES OF AMERICA,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

PETITIONER'S REPLY TO BRIEF FOR THE UNITED STATES IN OPPOSITION.

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PETITIONER'S REPLY TO BRIEF FOR THE UNITED STATES IN OPPOSITION.

The petition filed herein is directed primarily toward showing why a writ of certiorari should issue. Argument in support of the petitioner's contentions, that the Court of Appeals erred, has been touched upon only lightly and will be dealt with in detail in briefs filed upon the granting of the writ.

The brief filed in opposition to the petition, however, raises certain questions which if unanswered, even briefly, might give this Court erroneous impressions concerning the merits of the controversy.

1. The Government's brief (p. 6) states that the District Court found that the used connecting rods were

scrap, *i. e.*, unfit to perform their proper function as connecting rods, and that the Court of Appeals affirmed the District Court's judgment in its entirety.

The District Court did make such a finding (R. 93). Such finding was one of the points relied upon on appeal to the Court of Appeals (R. 98, Point 2).

The Court of Appeals, however, acknowledged that the used rods now being reconditioned had a commercial value of $1.10, as compared with scrap value of only three or four cents, and said (R. 111):

> "It seems perfectly clear, however, that the used rods it is now using are not in such a condition to give *satisfactory* service or the owners would not be offering them with money in exchange for plaintiff's reconditioned rods." (Emphasis supplied.)

The Court of Appeals thus actually acknowledged that the rods used in the present process of reconditioning, which were merely worn, were usable, and had commercial value as connecting rods, were not scrap except in the erroneous sense that scrap includes merely worn (as well as worn-out) articles of commerce.

This error of the Court of Appeals is one of the specifications urged (Petition for Writ of Certiorari, p. 6).

2. The decisions of courts of appeal, cited in the Government's brief (pp. 6-7) involve worn-out articles, not merely worn articles that have not lost their commercial function and value (Petition for Writ of Certiorari, p. 7). Approval of these decisions by Congress, and approval of Treasury Regulations providing that the term "manufacturer" includes a person who from *scrap, salvage or junk material* produces a taxable article, gives no support to the Court of Appeals' decision in the instant case, which holds that the term "manufacturer" includes a person who reconditions a worn connecting rod, which does not

render service to the satisfaction of its user, but which still is usable, has commercial value as a connecting rod, and is not worn-out.

3. The footnote argument in the Government's brief (p. 6), that the taxpayer (petitioner) may be concluded on the rebabbitting phase by *Clawson & Bals* v. *Harrison*, 108 F. 2d 991, is not founded upon points raised by the pleadings.

Even though transactions involved in different taxable periods are similar, the doctrine of *res adjudicata* does not apply. *Monteith Brothers Co.* v. *U. S.*, 142 F. 2d 139 (C. A. 7th); *Henricksen* v. *Seward*, 135 F. 2d 986 (C. A. 9th); *Campagna* v. *Harrison*, 135 F. 2d 334 (C. A. 7th); *Stoddard* v. *Commissioner*, 141 F. 2d 76 (C. A. 2nd).

Furthermore, the processes involved in the two periods were different in almost every respect (R. 47-48).

4. The statement in the Government's brief (pp. 9-10) that Section 3443(a)(1) of the Internal Revenue Code "provides for a credit only where the tax has already been paid on the sale to a manufacturer who, in turn, uses the article in the manufacture of another article on the sale of which a tax is imposed," is erroneous.

That section provides for a credit "to a manufacturer or producer, in the amount of any tax under this chapter *which has been paid with respect to the sale* of any article * * * purchased by him and used by him as material in the manufacture" of another taxable article.

The statute gives credit for any taxe paid with respect to the first *sale* of the article, whether sold and resold once or through a dozen middlemen before being purchased by a manufacturer for use in the manufacture of another taxable article.

5. The old *Clawson & Bals* case is founded upon differ-

ent facts, and was decided upon entirely different principles than those involved in the instant case. It involved worn-out articles having use and value only as scrap or junk.

The instant case, contrary to the Government's contention (Brief, p. 10), has gone beyond the "authoritative guides" of previous decisions and Treasury Department rulings, all of which have been based upon that same principle.

Under the decision of the Court of Appeals in the instant case, every automobile repairman who reconditions and improves the serviceability of an article which does not render "satisfactory service" in its worn condition will be subject to the manufacturers' excise tax. The Court of Appeals has, by its decision, abolished all distinction between "manufacture' and "repair."

This decision, if left unturned, will, in our sincere opinion, crop up time after time in the future in cases involving the distinction between manufacturers and repairers.

Respectfully submitted,

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